UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 10 CV 5760 (SAS)

SAMUEL E. WYLY, ET AL.,

Defendants.

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New York, N.Y.
February 4, 2014
4:30 p.m.

Before:

HON. SHIRA A. SCHEINDLIN

District Judge

APPEARANCES

U.S. SECURITIES AND EXCHANGE COMMISSION
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(In open court; case called)

THE COURT: Let me just help the reporter by doing this again. I said I would. You're Mr. Miller.

MR. MILLER: Yes, your Honor.

THE COURT: Ms. Fitzpatrick, Mr. Worland, Mr. Zerwitz. That's all the SEC.

In the second row we have Mr. Susman, Mr. Oxford, Mr. Shepard, and Mr. Susman, and Mr. Klein.

My goal today really is to rule on a number of the motions in limine, all the ones that are fully briefed. But just before I do I want to take up the issue raised by e-mail yesterday with my chambers where defense counsel, Mr. Stephen Susman, wrote to the court and asked that the trial that is now scheduled to be a jury trial become a nonjury trial primarily because his living client, Mr. Sam Wyly, has a number of medical problems which have just been confirmed by a letter from his doctor, which I've just been handed, dated February 3, that would prevent him from being able to testify for more than one to two hours at a time.

I must say my own sense of that problem/letter was that that wasn't any reason not to have a jury trial. So he can only testify for one to two hours at a time. We'll all work around that. If anything, I'm sure the jury would be extra sympathetic to your client as a result of his disabling condition.

But, either way, we have to work around it, whether it's jury or nonjury. So if that's the only basis, I wasn't inclined. But, of course, I would want to hear if the SEC consents. That's a different issue.

MR. S. SUSMAN: Your Honor, it's not the only basis.

THE COURT: What's the other reason?

MR. S. SUSMAN: The other basis is that you have to -- you're ultimately involved in this anyway. Only a very small portion of their claims is even triable to the jury.

THE COURT: Do we agree with that?

In other words, does the SEC agree on which portions -- excuse me one minute.

Does the SEC agree on which portions are jury and which portions are nonjury? Have you talked with them about that?

MR. S. SUSMAN: Yes, I have.

MR. MILLER: Briefly.

MS. FITZPATRICK: Your Honor, the SEC's position is that something is either triable to a jury or it is not.

THE COURT: Some issues are. Some claims are.

Do you at least agree on which claims are equitable claims, if they're only for the Court, which claims are claims at law that go to the jury? Can you agree with each other as to which is which?

MS. FITZPATRICK: I believe it's the remedy that makes

something equitable versus jury demandable. So the disgorgement remedy traditionally has not been jury demandable whereas the penalty remedy has been. The penalty remedy, in this case, is time limited. So there's a limited portion of time for which we can seek a penalty. Those claims, which are really every claim on which we would seek a civil penalty, are triable to a jury.

THE COURT: You're saying only some of the relief sought is equitable; there is no claim for injunctive relief, or declaratory relief, that sort of thing?

MS. FITZPATRICK: Much of the relief sought is equitable, and then the civil penalty which is also sought, which --

THE COURT: So there is injunctive relief? There is declaratory relief?

MS. FITZPATRICK: Yes.

THE COURT: Those are tried to the Court. Those are equitable remedies.

MS. FITZPATRICK: I believe traditionally the remedies are determined by the Court after.

THE COURT: Yes. I said injunctions and declaratory relief are equitable remedies. They're for the Court.

MS. FITZPATRICK: Yes.

THE COURT: In this case disgorgement might be equitable and for the Court. So what does that leave the jury

to do on the remedies side? Are there damages?

MS. FITZPATRICK: I think the Court would also determine the penalty in the remedies phase. But, the portions of the claims for which we still seek civil penalties, which are limited with respect to time but apply across the SEC's claims, are jury demandable.

THE COURT: On the liability side?

MS. FITZPATRICK: On the liability side, yes, your Honor.

THE COURT: So the jury says whether they find that defendants I guess violated certain things and, therefore, are liable for penalties?

MS. FITZPATRICK: Yes, your Honor.

THE COURT: For liability.

Mr. Susman, where do we disagree?

MR. S. SUSMAN: Well, as I understand it, the only thing -- issue triable by a jury is the liability for a penalty for conduct after 2001.

The statute of limitations governs liability for a penalty prior to that time. And liability for disgorgement is an equitable claim, which is triable to you. It's not triable to the jury, the liability.

The disgorgement claims are hundreds of millions of dollars. The penalty claims are like under $10 million. It's a huge -- most of the case is going to be calling on you anyway

to decide. So it just -- we thought that to get the thing quicker. We have a two-month trial with a jury, a complicated case, that ultimately is going to call on the Court to decide how much --

THE COURT: But if I recall, when I bifurcated damages, if, for example, some jury says no liability, I would not reach damages.

MR. S. SUSMAN: Absolutely. But we are --

THE COURT: Don't you want the jury to tell you that?

MR. S. SUSMAN: No.

THE COURT: No.

I understand. You want the "no liability" part. It doesn't matter who tells you. Got it. Okay.

MR. S. SUSMAN: We are comfortable with having the case tried to the bench.

THE COURT: Right. Okay. But if the SEC doesn't agree I can't -- I can't force that. They are entitled to a jury, right? You agree with that?

MR. S. SUSMAN: Only on that little issue.

THE COURT: Well, you call it "little." But the evidence isn't little. The remedy might be. In the end that might be the ten-million-dollar tail wagging the hundred-million-dollar dog. But the evidence is the same. It would support -- what is the SEC's position? Who is going to speak? Ms. Fitzpatrick.

MS. FITZPATRICK: Yes. Thank you, your Honor.

THE COURT: One second. Can I hear the SEC's position for a minute.

MS. FITZPATRICK: Yes, your Honor. Our position with respect to the evidence is that this is one large scheme. And while different portions of time may be --

THE COURT: I understand. What's your position with respect to jury versus nonjury.

MS. FITZPATRICK: Your Honor, respectfully, we learned of this request yesterday and we're still trying to think it through and its implications. We've been preparing for a jury trial for quite some time and thinking of our presentation and evidence in that manner. And we're just trying to think through the idea. We will -- we'll reach a decision quickly and can alert everyone by letter, but we need more than a day.

THE COURT: So you're not saying "no" yet. You're saying you haven't decided yet.

MS. FITZPATRICK: We're saying we haven't decided, but we're saying we have the right to demand a jury trial.

THE COURT: I think you do. I think you have the right to. I don't think you can be compelled to waive a jury. You're entitled to a jury. So I guess the question is should I be making any effort to persuade you, and the answer is no. You decide. Do what you have to do and let me know.

MS. FITZPATRICK: Thank you, your Honor.

THE COURT: But the prompter, the better. It is a long trial. And it's long for jurors if they have to be here. It's long for me. It's long for everybody.

So when do you think you could answer the question?

MS. FITZPATRICK: Perhaps a week, your Honor.

I believe Mr. French's attorney learned of this for the first time yesterday as well. And those decisions may be intertwined, or they may be independent. But I don't know if they've reached a decision on the issue yet either.

Do you have a right to demand a jury? Let's say the SEC and the Wyly defendants agree to not have a jury. Do you have the right to compel a jury?

MR. KLEIN: I don't think so, your Honor.

THE COURT: That takes care of Mr. Klein. One way or the other, he's going to have to along with the boat.

We're waiting for the SEC.

MS. FITZPATRICK: We'll try to reach the decision within a week, your Honor.

THE COURT: Today is Tuesday, February 4. So let's have a hard stop of Tuesday, February 11 so we all know where we're heading.

I don't know what the difference in presentation is. You said you've been planning on it and preparing and actually my nonjury trials are pretty similar. I require opening statements, and closing arguments. And I don't take direct by

affidavit. I take it live. It's not all that different in terms of preparation. I like little charts and graphs too and lots of pictures and posters. So I don't know if the preparation is really different.

MS. FITZPATRICK: That's actually helpful, your Honor, versus what a jury trial.

THE COURT: I take openings. I take closings. I take the whole thing. It's just the difference is there's often more work at the end without the jury. I mean very detailed findings of facts and conclusions of law. It takes sometimes longer to come out.

The jury has a verdict and the Court, even though the Court has to do a lot of work in this particular case on the remedies side, is still bound by the jury's findings of fact. Because I've tried jury and nonjury issues together on prior occasions and I have to follow their lead on the facts.

With that, I am afraid that you are now a captive audience, all nine of you, for a very lengthy reading. I apologize. The alternative is a written opinion, and I usually do a lot of written opinions, but there wasn't all that much new. I'm just ruling. So I'm going to forego it and read and read. So here we go.

The SEC has -- there's two nonexpert motions in limine. One, preclusion of the advice-of-counsel defense; and two, admission of statements made by various employees and

agents of the defendants under Rule 801(d)(2)(D).

Defendants submitted joint briefing on two nonexpert motions in limine seeking the exclusion of evidence about: One, nonsecurity transactions, such as purchases of artwork and jewelry; and, two, profits earned by foreign trust entities.

I begin with the SEC's motion, first being the advice-of-counsel defense.

In an opinion and order dated June 6, 2013, the Court denied the Wylys' motion for summary judgment on the aiding and abetting of fraud claims, "because defendants have not established any of the elements of the advice-of-counsel defense and there is evidence that the Wylys knew that their conduct made them beneficial owners of the issuer securities." The SEC argues that the evidentiary record has not changed since the summary judgment motion and that "because the defendants have failed to establish the factual predicate for the defense, evidence regarding the retention and presence or involvement of lawyers is not relevant and would confuse and mislead the jury." That's the SEC memorandum of October 16.

Defendants strenuously object. First, defendants argue that the summary judgment decision "did not foreclose defendants' reliance-on-counsel defense as a matter of law." And that's from the defendants' opposition brief of October 28.

Second, defendants argue that "a motion in limine is not a proper vehicle for a party to ask the Court to weigh the

sufficiency of the evidence to support a particular claim or defense because that is the function of a motion for summary judgment with its accompanying and crucial procedural safeguards."

Finally, defendants argue that evidence of attorney involvement is relevant even if defendants are not ultimately entitled to a jury instruction on the advice-of-counsel defense because such evidence is highly relevant to establishing the Wylys' state of mind.

The June 6, 2013 ruling did not foreclose defendants' advice-of-counsel defense as a matter of law. The issue the Court decided was whether or not the SEC established an issue of material fact as to scienter. It is neither accurate nor appropriate to now construe this ruling as a judgment as a matter of law on the advice-of-counsel defense. Further, the SEC may not now use a motion in limine to make a summary judgment motion it could have sought earlier. If defendants do not present the necessary evidence to justify a jury instruction on the advice-of-counsel defense, the SEC should ask the Court not to give it at the conclusion of trial. In any event, this evidence would be admissible regardless of the advice-of-counsel defense because it is relevant to the Wylys' state of mind.

I turn to the agent/employee statements.

The SEC seeks to introduce various statements from

eight current and former employees or purported agents of the defendants. The defendants concede that most of these individuals were agents or employees at some point in time but dispute that every statement these individuals made during that time period was within the scope of their agency. I will reserve rulings on the scope and relevancy of particular statements until they are offered. Defendants' specific objections to the agency status of certain individuals are as follows:

Beginning with Donald Miller and Evan Wyly.

Defendants argue that Miller is Charles Wyly's son-in-law and "occasionally represented or spoke on Wyly's behalf" and that Evan Wyly is Sam Wyly's eldest son and "works closely with his father and at times communicated with Sharyl Robertson, who is the family business CFO, on his father's behalf."Defendants disagree that these facts render Miller and Wyly agents throughout the entire period relevant to this case. The SEC responds that defendants do not contest that such authorization began before 1992 and was still in place through at least 2010. These facts do not render Miller and Wyly agents throughout the entire period. The Court will have to evaluate each proffered statement to determine whether it was made while the individuals were acting as agents.

Turning to Sharyl Robertson. Defendants dispute that Robertson's employment with Maverick Capital, a hedge fund

established by Sam Wyly and operated in the same building as the Wyly family office, made her an agent of the Wylys in and of itself. No ruling is needed here because defendants concede that Robertson was an employee of the Wylys from the late '70s until 1998 and was an agent of the Wylys by virtue of her role as a protecter of certain trusts from March '92 through November of 2004.

Turning to Michele Crittenden.

Crittenden was Louis Schaufele's primary sales assistant from '98 to 2004. Defendants disagree that Crittenden was an agent of the Wylys by virtue of her relationship with Mr. Schaufele. This argument is all the more important now that Schaufele is no longer a defendant. The SEC responds that Crittenden was an agent of Schaufele and that Schaufele was an agent of the Wylys as a result of his serving as their stockholder from 1992 through 2004 thus rendering Crittenden a subagent of the Wylys in the performance of her duties assisting Schaufele and servicing the Wyly-related accounts.

Quoting from the restatement (Second) of Agency, "A subagent is a person appointed by the agent empowered to do so, to perform functions undertaken by the agent or the principal, but for whose conduct the agent agrees with the principal to be primarily responsible."

From the same restatement. "A subagent performing

acts which the appointing agent has authorized him to perform in accordance with an authorization from the principal is an agent of the principal."

Bus Crittenden was a subagent of the Wylys only in the performance of her duties assisting Schaufele with the Wyly accounts, that is the extent of her agency status.

Turning now to Michelle Boucher.

Boucher worked for the Irish Trust Company, which I'll call ITC, as manager of finance from '95 to '99 and as CFO from '99 to 2010. The ITC, this have from the SEC's brief, "provided administrative services to foreign trusts established by or for the benefit of" the Wylys. The Wylys were not shareholders or officers of ITC, nor were they directly involved in day-to-day operations. Defendants agree that Boucher "conducted certain discussions with or provided necessary information to legal counsel on behalf of the Wylys but dispute that Boucher was the Wylys' agent throughout '95 to 2010 merely as a result of her position with ITC." That quote, of course, is if from the defendants' opposition.

Even though Boucher report to the CFO of the Wyly family office, defendants contend that there is no evidence "that she reported directly to the Wylys or that the Wylys were directly responsible for Boucher."

The SEC presents the following evidence to support Boucher's agency status: One, a declaration from Keeley

Hennington, the CFO of the family office since 2000, stating that Boucher represented the Wyly family office in connection with the Wylys' non-U.S. interests;" second, Special Master Capra's conclusion that Boucher was the Wylys' agent when resolving certain discovery disputes; three, statements from Boucher's deposition stating that she reported directly to Sharyl Robertson, the CFO of the Wyly family office from '92 to '98, and from Robertson's deposition that Boucher's salary and annual bonuses were decided by the Wyly family; and that, four, Boucher served as a co-protector of all the Wyly offshore trusts from 2001 through 2004 and as the sole protector from 2004 to 2010. The totality of this evidence, especially Boucher's own deposition testimony, supports the SEC's argument that Boucher served as the Wylys' agent during this time period.

Now I turn to the defendants' motions in limine, the first one being with respect to nonsecurity transactions.

The defendants seek to preclude the SEC from offering evidence of various nonsecurity transactions, including acquisitions of artwork and jewelry items by two foreign trust entities, as well as investments in real estate that was used or enjoyed by certain Wyly family members, and loans or charitable donations made by foreign trust entities. Defendants argue that while the SEC wants to introduce these transactions as evidence that the Wylys "controlled or enjoyed

the benefits of certain nonsecurity assets also owned by certain foreign trust entities, the receipt and enjoyment of an economic benefit from a security" is irrelevant to "determining beneficial ownership pursuant to Section 13(d)" of the Exchange Act. Much of that I was quoting from the defendants' memorandum on this issue.

The SEC responds that evidence of these transactions is "probative evidence that the Wylys controlled every aspect of their offshore system and their power to direct the expenditure of proceeds for personal benefit refutes their claims that they lack control over the trustees." That's a quote from the SEC's brief.

The SEC further contends that the evidence is probative to its Section 5, Section 13, and Section 16 claims. Finally, the SEC argues that the nonsecurity transactions are inextricably intertwined with the fabric of the fraud and necessary to complete the story of the fraud on trial. Defendants reply that the SEC has never argued that these transactions were unlawful and is seeking to introduce this evidence only to "transform the trial into an episode of Lifestyles of the Rich and Famous." I thought that was a nice line. That was from the defendants' reply memorandum.

Evidence that the trustees allowed defendants to receive personal benefits from these entities is probative evidence that the Wylys exercised control over the trustees.

This could, in turn, lead to an inference that they exercised control in terms of voting power and investment. For that reason, the SEC may offer evidence of the nonsecurity transactions. Defendants can rebut the potential prejudice by eliciting expert testimony that these transactions were lawful.

However, the SEC may not reference or offer specific evidence of the value of these personal benefits. Such evidence is unduly prejudicial. By way of example, it would be appropriate for the SEC to reference "a painting, jewelry, and charitable contributions," but inappropriate to say "a Picasso, a diamond necklace, and a one-million-dollar donation to the Dallas Symphony."

Turning now to profits earned by foreign trusts. The SEC plans to introduce evidence that Sam Wyly's offshore entities realized gains in excess of $370 million and Charles Wyly's offshore entities realized gains in excess of $180 million between '92 and 2004 allegedly "from undisclosed and frequently unregistered sales of Issuer securities." Defendants seek to preclude the SEC from offering any evidence or reference to "the profits earned by foreign trust entities, provided that the SEC may seek to offer other evidence of the foreign trust entities' holdings of the securities that the SEC alleges were beneficially owned by the Wylys." Long quote from the defendants' memorandum. Defendants argue that evidence of profits is not relevant to the materiality of any alleged

failure to file.

The SEC responds that this evidence "is relevant to several of the SEC claims because it shows the Wylys' scienter and the materiality of the fraud, and is also relevant to the SEC's false reporting claims, and its unregistered securities claim." Obviously, a quote from the SEC brief. This evidence is admissible because, as the SEC argues, the amount of gains realized is the direct result of the specific conduct that the SEC alleges was fraudulent and is relevant to a number of the SEC's claims.

Now I turn to the motions, the *Daubert* motions, starting with the SEC's *Daubert* motion.

The proponent of expert evidence bears the burden of establishing admissibility by a preponderance of proof. For expert testimony to be admissible under Rule 702, three requirements must be met. First the witness must be qualified as an expert by knowledge, skill, experience, training or education. Second, the expert's knowledge must be of the type that will assist the trier of fact understand the evidence or to determine a fact in issue. Expert witnesses are generally not permitted to address issues of fact that a jury's capable of understanding without the aid of expert testimony or about issues of law which are properly the domain of the trial judge and jury. Third, the proposed expert testimony must be based on a reliable foundation.

And that has been recently spelled out in the Second Circuit as follows. "In this inquiry, the district court should consider the indicia of reliability identified in Rule 702, namely, (1) that the testimony is grounded on sufficient facts or data; (2) that the testimony is the product of reliable principles and methods; and (3) that the witness has applied the principles and methods reliably to the facts of the case." That is a quote, as I said, from a 2002 Second Circuit case, long name, Amorgianos.

In sum, district courts are charged with acting as gatekeepers to exclude invalid and unreliable expert testimony. The SEC moves to exclude the testimony of three defense experts.

The first is Jonathan Macey. But defendants do not oppose the SEC's motion to exclude Professor Macey's expert opinion testimony. In the defendants' response of January 20 they so state.

Then there is Robert Ham and Gideon Rothschild.

At the October 7 conference I ruled that neither party can introduce evidence as to whether the Wylys did or did not comply with trust law. I also ruled that defendants may have a witness explain how the trusts work and how a trust operates because trusts are not common. And all this is from the transcript of the October 7 conference.

Defendants seek to offer expert opinion testimony from

Robert Ham and Gideon Rothschild, both of whom are practicing attorneys who specialize in Isle of Man and American trust law, respectfully. Ham makes the following five conclusion, and I quote from his expert report which was attached to the Zerwitz declaration. So this is a long quote. These are his five opinions.

"1. The trusts are not shams, nor are the trustee powers illusory under Isle of Man law.

"2. Both the trustees and the protectors are required to exercise their own judgment in performance of their functions under the trusts. The fact that, in practice, they may have followed requests from the protectors or the Wylys' wishes does not imply that the trustees and protectors did not, in fact, exercise their own judgment or act independently, or that the Wylys controlled the assets of the trusts or the companies owned by the trusts.

"3. The names of trusts and companies are not significant for present purposes.

"4. It is normal procedure to monitor assets held in family trusts.

"5. It is not surprising or significant that the Wylys and their families enjoy benefits from some of the trusts in question, or that the trustees exercised their powers in this regard in accordance with their wishes. This does not imply that the Wylys controlled the trusts."

The second person, Gideon Rothschild, makes the following five conclusions. Again, it's a quote from his report which, again, is attached to the Zerwitz declaration. And the five quotes are:

"1. The Wylys did not, and could not, control or have the power to control the decisions and actions of the trustees.

"2. The investments, asset transfers and securities transactions which the protectors recommended were made in a manner consistent with the provisions of the trust deeds, as well as the established practices of foreign trust administration.

"3. The trustees utilized discretion in ultimately deciding whether to effectuate such recommendations in accordance with the provisions of the trust deeds.

"4. The trustees acted independently in deciding whether to effectuate the protectors' recommendations.

"5. The trustees utilized the assets of the Isle of Man trusts for the use and enjoyment of the beneficiaries through investments, and the purchase of real estate, jewelry, artwork and other collectibles."

That's the end of the quote.

The SEC does not challenge the experts' qualifications or methodology, nor does the SEC dispute that the experts may testify about "basic trust concepts, trust operations in general, or even the specific terms of the Wylys' seventeen

offshore trusts." However, the SEC contends that Ham and Rothschild's opinions "regarding the propriety of the creation and operation of the Wylys' offshore trusts or their compliance with trust laws" are inappropriate in light of the October 7 rulings and exceed the scope of permissible expert testimony by reaching conclusions properly in the hands of a jury.

Defendants respond: One, they will only introduce evidence as to trust law compliance if the SEC opens the door with allegations that the trusts were a sham; two, that expert opinions as to legal ownership and control of the trusts, as well as the duties owed by trustees and protectors, are relevant to the issue of beneficial ownership; three, that opinions regarding the disposition of trust assets for the Wylys' use and enjoyment is relevant to rebut the SEC's evidence of various nonsecurity transactions; and four, that Ham's opinions that the trusts are not shams is relevant to rebut the SEC's scienter argument.

Some of Ham and Rothschild's proposed testimony is admissible. Ham and Rothschild may testify, first of all, about general principles of trust law, including legal concepts of control, ownership and fiduciary duties. And they can testify about specific provisions of the Wylys' trusts, including provisions governing ownership or control. Further, they may, if necessary, rebut certain allegations made by the SEC. For example, since the SEC is going to present evidence

of nonsecurity transactions, because I just allowed it, defendants can use these experts to elicit testimony that the nonsecurity transactions are not unlawful.

Ham and Rothschild may not otherwise testify about compliance with trust law. Ham's opinion that the trusts were not shams under Isle of Man law falls squarely within my prior ruling precluding testimony about compliance with trust law. Whether the trusts were, in fact, compliant with Isle of Man law is not at issue in this trial, nor is it relevant to scienter. Defendants may present evidence as to the Wylys' state of mind about the trusts through other testimony. However, I remind the SEC that my October 7 ruling also precludes testimony about noncompliance with trust law. The SEC may open the door to rebuttal expert testimony if it repeatedly questions the trusts' legal validity.

Ham and Rothschild may not testify about the propriety of anything the Wylys, trustees or protectors did. They cannot testify that the trustees exercised independent judgment and acted with discretion or that the Wylys did not control or did not own the trusts. These are highly contested factual and legal issues for the jury to decide.

Finally, the SEC contends that testimony from both experts is cumulative. It could well be, but I don't know which expert is going to testify about which opinions. I will say defendants are not permitted to call two experts to testify

to identical opinions, but Ham and Rothschild may turnout to testify without any overlap.

I turn to Erik Sirri. Professor Sirri is a former Chief Economist of the SEC and a former Director of the SEC's Division of Trading and Markets. Sirri's report consists of two parts. First, an analysis of the insider-trading claim; and second, an opinion on the materiality of the Wylys' nondisclosure of the Isle of Man transactions. The SEC does not challenge Sirri's qualifications but raises various issues as to the reliability of his data and methodology.

I begin with the insider trading analysis.

The SEC claims that the Wylys decided to sell Sterling Software in a merger or acquisition in October '99 and "caused their overseas entities to enter into equity swap transactions related to the Sterling Software stock with a Lehman Brothers overseas affiliate as a counterparty in order to profit from their undisclosed decision to sell." That's from the December 31 memorandum by the SEC on this issue.

Sirri's opinion has two components. First, he argues that the SEC's disgorgement calculation is overstated based on an analysis which tries to decompose the actual per share return over the relevant period of time to attribute the increase in share price to the different components, including the nonpublic information the Wylys allegedly traded on. Second, Sirri opines that the information the Wylys traded on

was not material.

I begin with the decomposition analysis.

The SEC argues that the decomposition analysis is not relevant to the liability phase of the trial which will not address disgorgement. Defendants respond that the analysis is necessary to rebut the SEC's theory of materiality. If the SEC will argue that the rise in Sterling Software share price after the public announcement of a merger proves materiality, then Sirri's analysis which concludes that the vast majority of the price increase was due to factors unrelated to the alleged nonpublic information is relevant for rebuttal. For that reason I will rule on the admissibility of Sirri's testimony at this time.

Substantively, the SEC contends that Sirri's methodology is unreliable. Sirri used an event study which, and I quote from the SEC brief on this issue, "Sirri used an event study which "involves the identification of an event that caused investors to change their expectations about the value of a firm" and compares the "stock price movement contemporaneous with the event to the expected stock price movement if the event had not taken place." The SEC contends that February 14, 2000, the day Sterling Software announced a potential merger, it is "the only possible relevant date for Sirri's event study and that the appropriate event window would allow for a few days before or after that announcement to

account for leakage of the information before the announcement date or a slight delay after that date to allow the market to react fully. In light of this standard, the SEC argues that Sirri's event window, a 129-day calendar period from October 8, '99 to February 14, 2000 is inappropriate.

The SEC also contends that Sirri's regression model, which is used to establish independent variable coefficients to compare against the 129-day event window, is unreliable for two reasons. First, the SEC argues that the regression model's baseline period, October 8, '97 and October 7, '99, is inapposite for the relevant holding period because the period between October 8, '99 and February 14, 2000 was unusually active in the technology industry. Second, the SEC argues that Sirri's regression model uses two market and industry indices that are highly and unnecessarily correlated.

Defendants respond that the regression model is a well known and accepted econometric technique for assessing the effects on a single stock price of market-wide and industry-wide price movements. Defendants argue that Sirri was aware of the extraordinariness of the 1999 or 2000 period and performed a regime shift analysis on his regression model to see if there were any structural breaks or other changes that would render it inapplicable. Sirri's analysis did not find any evidence that the regression model was inapplicable. The defendants also contend that regression models frequently have

a multicollinearity of indices.

The SEC does not challenge the use of a regression model, but rather Sirri's choices in developing his regression model. The fatal problem with Sirri's analysis is the 129-day event window. The current academic standard for measuring the effect of the release of information on a stock's price is to use a several-day event window extending "to the close of trading on the day after the release of the pertinent information." And I'm citing the Business Law article from 1994 by Mark Mitchell and Jeffry Netter which it turned out I cited in the Liberty Media v. Vivendi decision of 2013.

As defendants and the SEC point out, when Sirri performed a similar analysis in the SEC v. Mark Cuban case, Sirri used a five-day event window, including several days after the announcement. A 129-day event window is simply too large to be reliable in an event study.

Further compounding the problem of a 129-day event window is that the estimation window, that is the two years from October 8, '97 to October 7, '99, is too far removed from the market announcement to be helpful. Defendants are trying to show that the price increase from October '99, when the Wylys traded on the nonpublic information, to February 2000 when the merger was announced, could be attributed to many factors. But an event study is not a reliable way to demonstrate this. Sirri's event study appears to have been

designed to generate a particular outcome and is not based on sound or accepted methodology. For those reasons, the decomposition analysis is not admissible.

Turning then to the materiality opinion.

In addition to the decomposition analysis, Sirri offers the following opinion regarding the materiality of the February 14, 2000 disclosure on the Sterling Software stock price. And I quote from his report.

"The announcement on February 14, 2000 revealed information that was not known and could not have been known at the time of the execution of the Lehman swaps in October '99. Specifically, it incorporated subsequent developments that ultimately led to a successful merger, including the decision by Sterling Software's management to pursue a potential sale, the retention of Goldman Sachs, Computer Associates' indication of interest, the engagement of Broadview International, the outcome of mutual due diligence examinations, and the negotiations of the merger agreement and related documents."

That's the end of that quote from his report at paragraph 34.

Defendants argue that this opinion is based on Sirri's background, knowledge of and experience in the way that corporate mergers occur and the way that financial markets react to news of mergers. The SEC does not question Sirri's qualifications but questions Sirri's conclusion because the

SEC's expert shows that announcements regarding strategic alternatives commonly have a material impact on share prices.

This is exactly the kind of dispute juries commonly resolve in insider trading cases. The SEC points to a rise in stock price and says that the undisclosed information was material and then the defendant highlights other potentially relevant data points and say that it was not material. Sirri is qualified to comment about the types of factors that can have a material impact on stock prices. So this part is admissible.

Now to the impact of nondisclosure. The SEC alleges that the Wylys should have filed various forms, whether the Isle of Man trusts sold or bought securities from four issuer corporations because information pertaining to insider sales would have been material to a reasonable investor. Sirri's opinion examines the market's reaction to the Wylys' disclosed transactions, that is made by domestic trusts and Wyly insiders, and concludes that because there was no evidence of a statistically significant reaction to those disclosures, then the undisclosed transactions, which were made by the offshore trusts, were similarly immaterial.

The SEC contends, and Sirri now agrees, that the original dataset was incorrect because it assumed that the total domestic and the total offshore sales in the relevant period were roughly the same when, in fact, the offshore sales

exceeded domestic sales by a ratio of 20 to 1. Defendants contest that these were ministerial data counting errors and that Sirri has discovered, acknowledged, and corrected them. Defendants argue that Sirri's conclusion is unchanged because it rests on the size of the average domestic disclosed transaction which is comparable to the average offshore undisclosed transaction.

Further, the SEC contends that Sirri's analysis uses an inappropriately short window period to assess market reaction to disclosures and is unreliable for lack of sufficient data points. Sirri's analysis examines the stock market reaction to domestic transactions on the day the SEC stamped a disclosure form as received and then over a five-day period thereafter. The SEC argues that this is not an adequate event window to identify impact because the SEC's stamp on a disclosure form does not indicate that the information was publicly available on that date, and the information may not have become available to the market for several days after the date. The SEC also argues that Sirri's results are unreliable because the sample size is too small to be statistically significant. For example, there is only one disclosed transaction over a period of 2,079 trading days for Sterling Software and even the largest set of sample transaction, that of Michael Stores, only has 19 transactions over 3,267 trading days, which just to make it clear is twelve years.

Defendants respond that the filing date of the disclosure form is the standard day zero for such an analysis. Defendants also claim that Sirri performed additional calculations, which were sent to the SEC on December 22, 2013, which showed no evidence of market impact even over a ten-day event window. Finally, defendants argue that Sirri's opinion is reliable because it contains all available data related to the Wylys' disclosures.

At the outset, the SEC presents no evidence suggesting that a five- or a ten-day window is not an accepted window for such a study, nor does the SEC propose an alternate window. The SEC's brief merely alluded to the possibility that there may have been some delay between the date of filing and the date the form became available to the public. This does not mean that the information in the form was not available to the public at the date of the filing or that the five- or ten-day window was not long enough to show a market impact.

However, Sirri's methodology does have other flaws, which the SEC pointed out. While Sirri's testimony cannot be inadmissible based on sample size alone, the tiny sample size here renders Sirri's conclusions based on the average size of each transaction unhelpful. For some of the securities, there is only one disclosed transaction. And one is not a sample. Sirri's opinion about materiality based on the comparison between a handful of disclosed domestic transactions and the

average of far more frequent and sizeable undisclosed offshore transactions does not take into account the potential outlier nature of the domestic transactions and blurs together the characteristics of the much more prolific offshore transactions. The SEC highlights one example, and I quote from their brief at page seven, the reply.

"There was only one onshore sale of Sterling Software between '92 and 2000. That sale was for 300,000 shares making the average 300,000 shares. But there was nearly 7 million shares sold overseas during the same period for a purported average of 465,000 shares. To say the reaction of the market to this one domestic sale can stand as a proxy for the sales of 22 times more shares for the overseas sales during the same time period is ridiculous."

Although the Supreme Court has instructed district courts to focus "on the principles and methodology" employed by the expert and "not on the conclusions that they generate," it has recognized that "conclusions and methodology are not entirely distinct from one another." That is a quote from the Joiner case, 522 U.S. at 146. The data underlying Sirri's opinion is too meager and unreliable to support his conclusions. For these reasons, Sirri's opinion as to the materiality of undisclosed offshore transactions is inadmissible.

And that concludes my rulings on the issues fully

briefed to date.

We still have defendants' *Daubert* motions but they will not be fully submitted until, I guess, today. Yes. Today.

Is that right? No. March 4. Sorry. Opposition is due October 21. Reply March 4. And then I meet with you March 10.

MR. MILLER: Yes.

THE COURT: So that remains to be decided because it's not yet briefed. So those are the rulings. Obviously, it's hard to get it all when you just listen, but you'll have a transcript, and you'll be able to review it. I think we have no more business today.

MR. MILLER: We do, your Honor.

THE COURT: What is it? Because I don't have anymore time today.

MR. S. SUSMAN: Very quickly, your Honor.

THE COURT: Yes.

MR. S. SUSMAN: One is a scheduling issue.

THE COURT: Okay.

MR. S. SUSMAN: April 1, that evening my wife and I are being honored at a dinner in Houston at the Young Center.

THE COURT: That's fine.

MR. S. SUSMAN: So I know that that's the second day of trial. But would the court be willing to let us off at noon

that day if I'm back by noon the next day?

THE COURT: I think so. I might have some days that I can't sit either. I've got to get to the calendar.

MR. S. SUSMAN: I just wanted to mention it as quickly as I knew it.

THE COURT: No. I appreciate it. When does this trial start?

MR. MILLER: March 31, your Honor.

THE COURT: I can't be here April 4. I committed to some symposium on the rules of evidence. So there goes April 4. And then let's see if there's any others. I don't think so. That stayed pretty clear.

MR. ZERWITZ: The first two days of Passover are at some point in April as well.

THE COURT: I'll get there. The first Seder is the night of April 14. And the second is -- I would probably want to take off the 14th and the 15th, the Monday and Tuesday but not the holiday itself on Wednesday. Anybody have to take off the Wednesday? Nobody. Monday and Tuesday I usually take off. So that's the 14th and 15th.

Wait there's more. I agreed to speak at a very important symposium honoring Jack Weinstein in Chicago, which is on April 25. And I have to travel on April 24. So that's a short day too. No trial Friday the 25th and a short day on the 24th. I've got something written down Friday, May 2, but

I don't believe it, haven't been in contact for a while. I'm good to go until we're done. I hope you got all those dates. If you didn't, they're on the transcript.

So, yes, you can attend the dinner in which you're honored. Look, you've got four lawyers from your firm here. It may be that you can schedule some witness that you don't have to be here for; at least two of the four because one might want to be at your dinner, but the other two better forego it.

MR. H. SUSMAN: One better be there.

THE COURT: We can revisit, but that's the tentative schedule. Thank you for raising it.

What else? I've really got to go.

MR. S. SUSMAN: I'm sorry. Could we go off the record a second.

THE COURT: Yes.

(Discussion off the record)

MR. MILLER: On Friday February 14 the SEC is required by your order to submit a joint pretrial order to the defense. We're to exchange exhibit lists.

So we have a massive amount of material to exchange. And trying to engage in settlement at this point, I can tell your Honor we're just not going to settle unless there's admissions by the defendant -- well, by Mr. Wyly, Sam Wyly, admission to the allegations in the complaint, and then we could bifurcate and you decide the remedies. But short of

that, we're not going to go anywhere, your Honor.

THE COURT: I want you to sit down at least once with a good settlement magistrate and see if there's anything to talk about. I will figure out who it is and let you know promptly.

MR. MILLER: Thank you, your Honor.

THE COURT: All right. Can I go. Thank you.

Do we have another date in court?

March 10. Okay.

(Adjourned)